(20)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM—1925

No. [redacted]567

BOARD OF PUBLIC UTILITY COMMISSIONERS and HARRY V. OSBORNE, JOSEPH V. AUTENREITH and FREDERICK GNICHTEL, constituting said board

Defendants-Appellants

against

NEW YORK TELEPHONE COMPANY

Complainant-Appellee

BRIEF FOR APPELLANTS

- Not the printed Record -

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SUBJECT INDEX.

Supreme Court of the United States

OCTOBER TERM, 1925.

BOARD OF PUBLIC UTILITY COMMISSIONERS and HARRY V. OSBORNE, JOSEPH F. AUTENRIETH and FREDERICK GNICHTEL, constituting said board,
Defendants-Appellants,

against

NEW YORK TELEPHONE COMPANY,
Complainant-Appellee.

BRIEF FOR APPELLANTS.

The opinion delivered by the Court below is officially reported in 5 Fed. 2nd Ser. page 245.

The judgment to be reviewed is an interlocutory injunction order of the United States District Court dated May 12, 1925 (Record, p. 240), upon which a writ of injunction dated May 23, 1925 (Record, p. 242) was issued against the appellants.

The rulings made in the lower Court which are claimed to be erroneous and which are relied upon as the basis of this Court's jurisdiction are (1) the ruling that the Appellant Board in a proceeding to determine reasonable rates for service of a public utility is precluded from inquiring into the excessive charges made in the past by such utility for depreciation (Record, p. 238); (2) the ruling that even if the Appellant Board in such proceeding is not estopped from inquiring into the excessive de-

preciation reserve accumulated by such utility, said Board, nevertheless, cannot fix lower depreciation charges for the appellee than what are normally required, until such time as such excess accumulated in the past shall be absorbed in future earnings (Record, pp. 238, 239); (3) the ruling that such excess in the amount accumulated by the appellee in the depreciation reserve fund is the absolute and unqualified property of the appellee (Record, pp. 238, 239).

The statutory provisions under which the jurisdiction of this Court is invoked are found in Section 266 of the Judicial Code (Act of March 3, 1911, Ch. 231; 36 Stat. L. 1087) which provides that an appeal may be taken to this Court from an order of a lower court granting an interlocutory injunction restraining the enforcement of an order made by a State Board—the Board of Public Utility Commissioners of New Jersey—pursuant to a statute of that State (Chap. 195, Laws 1911, New Jersey).

The cases sustaining this Court's jurisdiction are numerous. *Louisville, etc., R. Co.* v. *Garrett*, 231 U. S., 298; *Prendergast* v. *N. Y. Telephone Co.*, 262 U. S., 43; *Georgia Railway & Power Co.* v. *Railroad Commission*, 262 U. S., 625. The appeal in cases like the instant one must be taken direct to this Court. (*Jackson* v. *Cravens*, 238 Fed., 117.)

Statement of the Case.

The appellants are an administrative board of the State of New Jersey possessing the rate regulating powers of that State over public utilities by virtue of Chapter 195 of the Laws of 1911 of New Jersey. Section 16 (d) of that act gives the Appellant Board power to require every utility to file with it schedules of rates, and the Board's procedure requires every utility which proposes to change its rates to file a schedule of such changed rates with the Board.

The appeal herein was taken by the appellants for the purpose of reviewing the order of the District Court of the United States for the District of New Jersey, consisting of three Judges in accordance with Section 266 of the Judicial Code, made on May 12, 1925, and entered in the office of the Clerk of the District Court aforesaid on said date, which order granted an interlocutory injunction during the pendency of this cause, restraining the appellants from attempting to compel the appellee to observe or keep in force the rates for telephone service required to be continued in effect by the order of December 31, 1924, of the Appellant Board of Public Utility Commissioners, or otherwise to observe or comply with any of the provisions of said order (Record, p. 240).

The said order of December 31, 1924, made by the Appellant Board (Record, pp. 16, 18) was the result of an investigation made by it as to the reasonableness of certain rates increasing the then existing rates which the appellee proposed to put into effect in that part of the State of New Jersey in which it operates. The order in question prevented the imposition of the proposed rates at that time, principally upon the ground that the depreciation reserve fund which the appellee had accumulated was greatly in excess of what was adequate, and that the appellee was setting aside from its earnings annually for such reserve an excessive amount. The Board fixed what it considered to be proper depreciation rates. In view, however, of the excess which appellee had accumulated in the reserve fund for depreciation (Record, pp. 49, 50) the Board ordered that a reduction be made by the appellee of the amounts from revenues which it deemed ordinarily proper for that purpose until such excess should be absorbed. It permitted the appellee, however, to apply the difference between such temporary allow-

ance for depreciation and that which the Board deemed ordinarily just, to be applied to the making up of a fair return on the fair value of the appellee's property. That is to say, the Board found the total excess in the reserve fund to be $4,984,009, and the normal amount required for annual depreciation $2,678,386 (Record, p. 50), but did not allow the company after January 1, 1925, to deduct the full latter sum and ordered it to use enough of said $2,678,386 to bring the return on the value of its property up to 7.53 per cent. until such time as it should thus have absorbed $4,750,000 of such excess in the reserve fund (Record, pp. 17, 61). This action of the Appellant Board was held to be confiscatory of the appellee's property by the Court below in and by the order appealed from herein, and the appellee was by said order of the Court below permitted to collect the increased rates from its customers in New Jersey, numbering about 250,000, during the pendency of this suit. There is no question here as to the fairness of the valuation of the appellee's property which was made by the Board nor of the adequacy of the rate of return, viz; 7.53 per cent. which the Board allowed, nor of the fact that there is a surplus exceeding $4,750,000 in the appellee's depreciation reserve.

The Court decided the case as above stated upon the sole ground that the action of the Appellant Board with reference to current depreciation rates and the accumulated depreciation reserve was illegal (Record, p. 238).

The Court found that such action of the Board presented two questions which may be best expressed in the Court's own language (Record, p. 238):

> "First, whether the Board may now be heard to say with retroactive effect that the charges made in the past by the plaintiff were excessive; and,

second, even if it be conceded that they were, whether that fact would confer upon the defendant the right and power to base an order with respect to future rates upon a result or rate of return obtained by allowing to the plaintiff as a depreciation expense a sum less than the Board itself finds to be the actual, normal, currently accruing depreciation."

Deciding both of these questions in the negative the Court held that the Board's action was confiscatory of the company's property and did not permit it really to earn the fair return of 7.53 per cent.

Preliminarily to the discussion of the propriety of the Court's decision with reference to these two questions we shall set forth in Point I, *infra*, the power of the Board to regulate rates and in Point II, the nature and character of depreciation expense and depreciation reserve.

The assignments, therefore that are intended to be urged are those numbered 4, 5, 6, 7, 8 and 9 which allege error in the Courts ruling on the questions of the Board's power with reference to current depreciation rates and the depreciation reserve fund of the appellee (Record, p. 245).

POINT I.

The appellant Board has the power of the State to fix just and reasonable rates for service by utilities and to fix proper depreciation charges.

Chapter 195 of the Laws of New Jersey, Section 16 (c) provides that the Board shall have power after hearing to fix just and reasonable rates for any public utility.

Section 17 (h) of that Act provides that when any public utility shall increase any existing rates the Board shall have power to hear and determine whether such increase

is just and reasonable and the burden of proof to show that the increase is just and reasonable shall be upon the public utility making the same.

Section 17 (f) of the Act authorizes the Board

> "to require every public utility to carry, whenever in the judgment of the Board it may reasonably be required, for the protection of stockholders, bondholders or creditors, a proper and adequate depreciation account in accordance with such rules, regulations and forms of account as the Board may prescribe.
>
> "The Board shall from time to time ascertain and determine, and by order in writing after hearing fix proper and adequate rates of depreciation of the property of each public utility in accordance with such regulations or classifications, which rates shall be sufficient to provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to the rates so ascertained, determined and fixed, and shall set aside the moneys so provided for out of earnings and carry the same in a depreciation fund. The income from investments of money in such fund shall likewise be carried in such fund. This fund shall not be expended otherwise than for depreciation, improvements, new constructions, extensions or additions to the property of such public utility."

POINT II.

Depreciation expense is a charge made against earnings periodically to care for depreciation of the utility's property not covered by current repairs.

Depreciation reserve is the fund accumulated from such depreciation charges.

Depreciation—Its Purpose and Use.

The Interstate Commerce Commission's instructions pertaining to the annual allowances for depreciation in "Uniform System of Accounts for Telephone Companies," define depreciation expense as follows:

> "(a) The losses suffered through the current lessening in value of tangible property from wear and tear (not covered by current repairs).
>
> "(b) Obsolescence or inadequacy resulting from age, physical change, or supersession by reason of new inventions and discoveries, changes in popular demand, or public requirements, and
>
> "(c) Losses suffered through destruction of property by extraordinary casualties."

The Interstate Commerce Commission rules further provide that:

> "The estimate for depreciation of physical property should take into account:
>
> "(a) The gradual deterioration and ultimate retirement of units of property which may be satisfactorily individualized, such as buildings, machines, valuable instruments, etc., to the end that by the time such units of property go out of service there shall have been accumulated a reserve equal to the original money cost of such property plus

expenses incident to retirement less the value of any salvage.

"(b) The depreciation accruing in property which cannot be readily individualized, such as pole lines, wires, cables, or other continuous structures, where expenditures for repairs or replacements of individual parts ordinarily are not actually made until the later years of the life in service of such property, and when made may, therefore, be classed as extraordinary repairs."

Inasmuch as the company's property deteriorates, wears out and is consumed through use and the ravages of time it becomes necessary for the company to provide for this through appropriate charges in its operating expenses to the end that it may keep its property intact and continue to furnish service uninterruptedly.

Depreciation charges (which, computed on an average basis, are amounts the company estimates it will ultimately need to replace its investment in property units when they are finally retired) are therefore included in the operating expenses and corresponding credits are made to a depreciation reserve.

When units of property become worn out or used up and are actually retired the original cost of each property unit is written off from the fixed capital account and a corresponding debit (less any net salvage realized) is made against the depreciation reserve.

The depreciation reserve then is the accumulation of depreciation charges (charged in operating expenses) as yet not actually used for the purpose, but intended to ultimately reimburse the company for its investment in property units as those units are used up and actually retired.

The depreciation reserve is actually invested in the

company's property and will always be available for such use so long as the current depreciation charges included by the company in its expenses as depreciation expense and credited to the depreciation reserve, are not less than the current debits to the depreciation reserve because of property units retired.

The accrued depreciation in the company's property may or may not be equal to the depreciation reserve, for the depreciation in the property is the result of wear, use, the elements, obsolescence, inadequacy, etc. The depreciation reserve depends upon the financial provision which the company has made for the ultimate replacement of its investment in plant units when and as they are retired and is founded wholly on opinion estimates as to the lives of plant units and the salvage to be realized from plant units to be retired many years in the future.

In *Knoxville* v. *Knoxville Water Company*, 212 U. S., 1, Mr. Justice Moody said:

> "Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs, but for making good the depreciation and replacing the property when they come to the end of their life. The company is not bound to see its property gradually waste, without making provision out of earnings for its replacement. It is entitled to see that from earnings the value of the property invested is kept unimpaired, so that, at the end of any given term of years, the original investment remains as it was at the beginning. It is not only the right of the company to make such a provision, but it is its duty to its bond and stockholders, and in the case of a public service corporation, at least, its plain duty to the public."

This quotation makes it clear that the allowance in ex-

pense for depreciation is required in the interest of the bond and stockholders on the one hand and the public, concerned with continuously adequate and proper service, on the other hand.

It likewise makes it clear that the measure of allowance is the sum required to assure that "the original investment remains as it was at the beginning," and that its purpose is "the making good the depreciation" and replacing the units of property "when they come to the end of their life."

It also makes it clear that the allowance cannot be considered profit for it is taken by the utility before and in addition to profit for the specific purpose above indicated.

It follows that the depreciation reserve is built up not merely in protection of the integrity of the investment of the bond and stockholders but in the protection of the interest of the public in continuously adequate service as well.

This reserve is the property of the company only in the sense that the legal title thereto rests in it, but its right of property therein is qualified by the public interest in protection of which the reserve is built up.

The Public Utility Act of New Jersey (P. L. 1911, Chapt. 195) in Section 17 (f) recognizes the qualified nature of the ownership of the reserve, in that it provides that the reserve, "shall not be expended otherwise than for depreciation, improvements, new constructions, extensions or additions to the property of such public utility" and that the income from investments of moneys in the reserve shall be carried to the credit thereof.

POINT III.

The Court erred in holding that the excess in the depreciation reserve was the absolute and unqualified property of the appellee.

This is assignment of error Number 8 (Record, p. 245).

The lower Court's finding on the first of the two propositions quoted page 4, *supra*, forming the basis of its decision, was that the Board could not inquire into the surplus in the appellee's depreciation reserve because such surplus is to be considered as profit and is now part of the company's property.

We maintain that the excess in the depreciation reserve is not profit and is not the property of the company to do with as it may, but having been prematurely and unnecessarily taken from the rate payers the Board may give the rate payers the benefit of such excess when fixing rates for the future.

The stockholders and bondholders having been adequately protected by placing in the depreciation reserve all the money that is needed for that purpose, the balance —that is—the surplus of $1,750,000 is in the nature of a trust fund for the benefit of the public from whom it has been prematurely taken.

The quotation from *Knoxville* v. *Knoxville Water Co.*, *supra*, indicates that the reserve is for the benefit of the public as well as the company and that all that the company is entitled to is that its original investment shall remain unimpaired. The company's investment not only remains unimpaired but it has the above surplus in its reserve fund. The Board did not take this surplus away from the company but directed it to refrain from adding to it until the depreciation reserve requirements of the property should come to equal the depreciation reserve

actually accumulated. The Court's opinion refers to it as "profit," acquired by the company. It is not profit because as Justice Moody said in the Knoxville case *supra* it is something set aside before and in addition to any profit.

If it were profit it could be added to capital or disbursed to the stockholders in dividends but it cannot be so used, nor is it to be considered as part of the property of the company which the latter absolutely owns.

In *Louisiana R. R. Commission* v. *Cumberland Tel. & Tel. Co.*, 212 U. S., 410, this Court held that:

If a public service corporation raises more money in a particular year than required for actual depreciation it cannot carry the excess to capital for the purpose of estimating the amount on which it is entitled to pay dividends in determining whether a rate is unconstitutional as confiscatory, and the onus of showing that this has not been done is on complainant where the books show that such an excess has been collected.

The Court below in that case had enjoined the enforcement of certain rates prescribed by the railroad commission. Such rates superseded and set aside other rates which had formerly been established by the same commission. Included in the investment of the company was an amount set aside for the depreciation reserve fund. The case was similar to the one at bar.

The Court says, page 424:

> "It was obligatory upon the complainant [the Telephone Company] to show that no part of the money raised to pay for depreciation was added to capital upon which a return was to be made to stockholders in the way of dividends for the future. It certainly was not proper for complainant to take the money, or any portion of it, which it received as a result of the rates under which it

was operating and so to use it, or any part of it as to permit the company to add it to its capital account, upon which it was paying dividends to its stockholders. If that were allowable it would be collecting money to pay for depreciation of the property, and having collected it, to use it in another way, upon which the complainant would obtain a return and distribute it to its stockholders. That it was right to raise more money to pay for depreciation than was actually disbursed for the particular year there can be no doubt, for a reserve is necessary in any business of this kind, and so it might accumulate; but to raise more money than enough for the purpose and place the balance to the credit of capital upon which to pay dividends cannot be proper treatment."

It must be remembered that in the instant case the Court assumed that the company was getting a fair return on its property during the years that the excess in the depreciation reserve fund was being accumulated. This excess was accumulated unnecessarily, if not improperly, and at the expense of the rate payers. Having been taken from the rate payers for a purpose for which it was not needed the Board had the right to say as it did to the company:

"You ask an increase in rates. You have taken too much in depreciation charges annually from the revenues received by you from the public, so that now you have $4,750,000 more set aside in your reserve for the depreciation of your plant than is necessary. While we permit you to keep that sum, we do not intend to allow you to take it twice and therefore we direct that hereafter you shall not set aside for depreciation annually the amount which you would have the right to appropriate for that purpose if you had not already taken too much, but shall use the sum you

> should ordinarily set aside for such depreciation in paying to yourself instead, a fair return on your capital investment until in this manner you have absorbed the amount of the excess in your depreciation reserve, to wit, $1,750,000."

The appellee cited in its brief below and the Court relied on *Newton* v. *Consolidated Gas Co.*, 258 U. S., 165, as the basis for its opinion that the excess in the depreciation reserve fund is the property of the appellee (Rec., p. 238, fol. 241).

That case does not apply. In that case the contention was made that because the public utility had in former years made large profits which had been distributed to its stockholders it should forego a reasonable return for some time in the future. The case at bar is different, however, first because as we have shown, the excess in the depreciation reserve fund has not been distributed and cannot legally be distributed to stockholders; is not the property of the company and is affected with a public interest. *Knoxville* v. *Knoxville Water Co., supra. Louisiana Commission* v. *Cumberland Telephone & Telegraph Co., supra.* The case at bar differs from Newton Consolidated Gas Co., secondly because the appellee is not asked to forego a reasonable return, but in fact, is allowed to make a reasonable return—7.53 per cent.—by the Board's decision.

The action of the Board is in accordance with the general practice regarding the treatment of excessive reserve for depreciation.

In *Georgia Ry. & Pr. Co.* v. *Railroad Com.*, P. U. R. 1925, A, page 594, a Federal case not officially reported, the Master (after quoting the authorities) says:

> "To allow a reserve which, during the estimated life of the plant would amount to more than the

> original investment, would be to give the utility, out of rates collected from the public, not only a reserve, sufficient to keep its investment unimpaired, 'so that at the end * * * the original investment remains as it was at the beginning,' but additional capital also. The utility should be allowed reserve for replacement sufficient to keep the investment unimpaired and in addition, a fair return upon the present value of the property, but the public should not be required to build up, in the form of maintenance reserve, additional capital for the utility. * * * To allow reserve on this basis would, to the extent of the additional capital furnished by the public, amount to the confiscation of the property of the users of gas."

In *Re Thompson*, P. U. R. 1922, A, 558, a case before the Illinois Commerce Commission on application for increase in rates, the Commission found that the applicant had accumulated a large amount of what was called a renewal fund of the company's. This amount, the Commission found, was sufficient for present purposes of the fund and ordered that no further additions or accumulations therein should be made until the further order of the Commission.

In *Re Eaton Rapids*, P. U. R. 1922, D, 94, a case before the Michigan Public Utilities Commission on application for increase in rates. The Commission determined that the utility should earn for depreciation requirements considerably less than it had during some time previous.

In *Re Consumers Company*, P. U. R. 1923, A, 430, the Idaho Public Utilities Commission determined that the depreciation reserve is over accrued, that is to say, the amounts already paid in by the customers of the company were larger than were necessary, so that for the next few years, at least, there was no reason why further earnings should be exacted for the purpose of increasing

a reserve which was already too large, therefore, no amount for depreciation expenses was included in the rate applied for.

In *Re Southern California Edison Company*, P. U. R. 1924, C1, the California Commission held that the reserve fund should be accounted for so that the Commission could make adjustments.

In *Re Utica Gas Company*, P. U. R. 1922, A, 558, the New York Commission found the company had accumulated an excessive depreciation reserve fund and ordered it not to make any further accumulation for this purpose.

The second of the two questions upon which the Court made its decision turn was: Conceding that the Board has the power to determine that the depreciation reserve is excessive, would the Board in view of such excess have the right in fixing future rates to allow appellee as a depreciation expense a sum less than the Board finds the normal current depreciation to be? We have heretofore necessarily considered this question. We have shown that it is neither "profit" nor "property" of the appellee and that having been taken prematurely and unnecessarily from the public it is held in the character of a trust fund for the benefit of the public. The Board had the right to prevent the taking of any additional depreciation until the excess should be absorbed, and it could require that the sum ordinarily needed for depreciation should be used in another way, *i. e.*, to make up a return of 7.53 per cent. upon the value of the appellee's property.

Taking a concrete example, suppose the appellee installed in 1914 a pole costing twenty dollars and having, according to the appellee's experience, an average expected life of twenty years in service; in 1924 this pole would be ten years in service and one-half of its useful life would have expired. The appellee should have its

original twenty-dollar investment unimpaired, but suppose that the appellant Board found it to have accumulated in its 1921 reserve not ten dollars but fifteen dollars; does the appellee suffer any injustice if the Board should order it to forego further charges to depreciation expense with respect to this pole until five years or less shall have expired; or to carry the example further, suppose at the end of the ten years the Board should find the appellee had charged to expenses and credited to depreciation reserve twenty dollars, the entire cost of the pole; would the appellant Board be depriving the appellee of any property or rights by ordering it to cease making any further charges to depreciation expenses to create any additional reserve with respect to this pole? But under the lower Court's ruling it may continue to charge annually the average sum of one dollar a year notwithstanding that it had already 100% of the cost of the pole in its reserve.

At December 31st, 1921 the company's depreciation reserve amounting to $19,163,626 (Hill's Affidavit, p. 8) is composed of a multiple of just such excess charges as illustrated above. Can it be reasonably argued that the Board deprived the appellee of its property, in decreasing future charges to depreciation expense until the overcharge of $4,750,000 shall have ceased to exist? Or, to give another illustration, suppose Jones leases an office from Smith for five years at a rental of $5,000 per annum. Through an error in the second year Jones pays for the second and third years' rental. Is Smith deprived of property lawfully his if Jones in the next or third year, on being billed for this rent and having discovered the error, says, "You collected my rent for the third year last year, and I am not going to pay you a second time." But says Smith, "I am entitled to a year's rent each year." Should Smith get it a second time and

is Jones estopped from claiming that it is already paid once and it should not be required of him a second time? If the principles laid down by the District Court in this case are sound, he should pay a second time because he is estopped to claim the benefit of the excess payment in the prior year.

In the Court below the appellee made the claim that the United States Supreme Court has decided that the State Board could not interfere with an excessive depreciation reserve fund in the case of *New York Telephone Company* v. *Prendergast*, 262 U. S., 43. The appellee may make the same claim here. The Court below was satisfied however that the claim was without merit. Certainly the Court below would have seized upon that case as the basis for its decision as a simple and easy way of disposing of this case if it considered that that case had decided the question. A reading of the opinion in the Prendergast case will show that this Court did not refer to depreciation and probably did not consider it as it was not necessary to do so. This Court decided the case on other grounds entirely. It is not to be assumed that this Court decided any question which the opinion shows it did not decide.

POINT IV.

The Court erred in holding that the appellants were estopped from inquiring whether there was an excess in the depreciation reserve; and finding such excess, from requiring that such excess be absorbed.

The Court invoked the doctrine of estoppel and adjudged that since the appellants had existed since 1911 with supervisory power over the appellee's rates and over

the sum included in such rates for depreciation expense and in contribution to the depreciation reserve, and since the appellants had not exercised their power to require appellee to reduce the allowance for this item of expense, they were estopped even though the depreciation reserve built up by means thereof was excessive, from taking such fact into account in their determination as to what allowance on the score of depreciation should be made in the future.

In this we submit the Court erred.

We believe that what we have said under Point III, *supra*, is also an answer to the Court's suggestion of an estoppel but will briefly discuss it further.

In order that there may be a basis of estoppel it must at least appear that the appellee had been misled to its disadvantage by the non-action of the appellants.

There is no foundation for the claim that the appellee was so misled.

If the appellee assumed that any excess in depreciation reserve might be regarded and dealt with by it as profit, its mistake was one of law in nowise attributable to the inaction of appellants.

But beyond this it nowhere appears that the appellee in fact had acted on the assumption that such excess might be distributed or employed by it as profit; nowhere does it appear that in reliance upon appellants' inaction the appellee had regarded itself as relieved from the statutory limitation as to the uses to which such reserve might be put. In fact it was not, under the statute, within the power of appellants to relieve appellee from such limitation.

In carrying the excess upon its books in and as part of the depreciation reserve the appellee recognized that, although in fact it had gone into its property and was not

represented by cash in bank, the so laying of it out was an investment of the fund, which no more lessened the fund than would the investment of a like sum in securities.

The appellee not having been misled to its disadvantage the doctrine of estoppel has no application in the instant case.

In fact, the record shows that the Court below was mistaken in assuming inaction by appellants.

The decision of appellants which was before the Court below states (Rec., p. 51):

> "The company has been on notice for years that is has been charging too much of expenses to create this reserve. As far back as the 1916 rate case the Board (Vol. V, N. J., P. U. R., p. 637) indicated that the company was charging an excessive amount to its expenses to provide for these reserves ($110,387 minimum—$394,544 maximum per annum). In 1919 the company claimed that it had charged $418,000 too much to depreciation expense (VIII, N. J., P. U. R., p. 555)."

If the theory of the Court below that the Public Utility Board of a great and populous State like New Jersey is to be held guilty of laches and estopped from inquiring into and regulating excess accumulations in the depreciation reserve of a utility, it will mean that the public utilities of the country will take unnecessary sums for this purpose with impunity and can never be called to account therefor. It must be remembered that as a practical matter, the question as to whether or not the company is at any time charging too much or too little to depreciation expense can only be ascertained by an examination of the state of the depreciable property of the company in order to determine its percentage condition and existing depreciation. In a company of the

size of the plaintiff in this matter, such an examination requires great detail and is enormously expensive. This appellant Board has all the utilities of the State under its jurisdiction and it is manifestly not possible for it to currently and continuously effect such examination and ascertainment of the physical depreciation accruing in each of the utilities' property under its jurisdiction. Only when the matter arises as it has in this investigation of rates, is it practicable to check the percentage of depreciation found to be actually existing in the property with the percentage of depreciation reserve accumulated by the company to reimburse it for such depreciation or loss in value. With respect to the appellee in this cause, only twice has the opportunity been afforded the Board of checking the amount of reserve against the physical state of the property, the first time in 1916 and the last time in the investigation of rates from which this present action arose.

It is respectfully submitted that the interlocutory order appealed from should be reversed and the injunction granted thereon should be dissolved.

THOMAS BROWN,
Counsel for Appellants.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM—1925

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BRIEF FOR APPELLANTS IN REPLY.

This reply brief is made necessary by the action of the appellee in incorporating in its brief matters that in our judgment are not presented to this Court on this appeal. Our main brief in accordance with the rules of this Court addressed itself concisely to the sole ground of appeal in the case. That ground of appeal is set forth in our assignments of error and is the ruling that the excess in the amount accumulated by the appellee in its depreciation reserve fund is the absolute and unqualified property of the appellee and cannot be used as a set-off by the Board to the appellee's claim for increased rates.

We had not supposed that appellee's brief would deal with any other questions than the one presented by the appeal and assignments of error. We refer particularly to all matters discussed under Point III in appellee's brief, which point undertakes to prove that the appellant Board

did not value the appellee's property correctly or fix a proper allowance for depreciation of that property. We refer also to Point II of appellees brief which is not directed to the point of the appeal in this case but which is a claim that the appellant Board had no jurisdiction over the appellee the theory of the argument being that the appellee is subject only to the Interstate Commerce Commission.

The matters dealt with in Points III and II of appellee's brief were before the Court below and that Court found against the appellee on all those matters—decided expressly against it on the matters covered by Point III and decided impliedly against it on the matters covered by Point II by ignoring appellee's contention.

There is no question here as to the fairness of the valuation of the appellee's property which was made by the Board nor of the adequacy of the rate of return, viz; 7.53 per cent. which the Board allowed, nor of the fact that there is a surplus exceeding $4,750,000 in the appellee's depreciation reserve.

The above statement was made in the statement of the case in our brief. It is criticized in the appellee's brief page 8, as being unjustified as each of the matters above mentioned was disputed by appellee. The appellee's brief then states that it proposes to discuss those questions in its brief and does throughout its brief discuss those questions.

We insist that our statement above is correct and that the questions of the value of the appellee's property, the rate of return thereon and the fact of an excess in the depreciation reserve fund of the appellee are not before this Court on this appeal.

The Court below for the purposes of its decision refused to accept appellee's view that the value of its property was higher than that fixed by the appellant Board and that there was not an excess in the depreciation reserve. The Court assumed that the Board was right in those findings, but admitting that the Board was correct in its findings in those respects the Court held that the Board could not consider the excess in the depreciation reserve in fixing rates for the future (R., 238).

We contend that the appellee cannot discuss those questions here. If it desired to attack the decision of the Court below in those respects it should have taken an appeal from the decision. It did not. It cannot now ask this Court to overrule the Court below in regard to questions on which that Court found against it. The appellee cannot use appellants' appeal to reverse any finding of the Court below.

We maintain therefore that all that part of appellee's brief which is devoted to purpose of showing undervaluation of the appellee's property, inadequacy in the amount allowed as current depreciation charges or the nonexistence of an excess in the depreciation reserve fund, and in particular Point III of appellee's brief are irrelevant to the case before this Court on this appeal.

The appellant Board was not precluded by the Interstate Commerce Act or the regulations of the Interstate Commerce Commission from fixing charges for depreciation expense for the appellee.

Point II of appellee's brief asserts that the company's charges for depreciation are regulated by the Interstate Commerce Commission and its jurisdiction is exclusive.

While we do not consider that this point is pertinent to the appeal herein for the reasons hereinbefore stated

we make reply to it and will discuss the effect of Congressional action on the jurisdiction of the appellant Board.

a. Congress in extending the power of the Interstate Commerce Commission to telephone companies engaged in interstate commerce, enacted:

> "Provided, however, that the provisions of this act shall not apply to * * * the transmission of messages by telephone * * * wholly within one state, and not transmitted to or from a foreign country, from or to any state or territory * * *" (U. S. Comp. St. Supp. 1911, p. 1285).

This proviso constitutes an express declaration by Congress that the jurisdiction conferred upon the Commission shall not extend to the intrastate transmission of messages by telephone.

b. *Each state is therefore free, notwithstanding the extension of the jurisdiction of the Interstate Commerce Commission, to establish intrastate telephone rates, although the state's requirements may disturb the relation between intrastate and interstate rates.*

This proposition is fully supported in the following cases:

In the Minnesota Rate Case (*Simpson* v. *Shepard*), 230 U. S. 352, the State of Minnesota had established reasonable rates for intrastate transportation throughout the state, and it was contended that, by reason of the passage of the act to regulate commerce, the state could no longer exercise the state-wide authority for this purpose which it had formerly enjoyed; and the Court was asked to hold that an entire scheme of intrastate rates, otherwise validly established, was null and void because of its effect upon interstate rates. There had been no finding by

the Interstate Commerce Commission of any unjust discrimination. The Court under the conditions refused to hold that the State was deprived of jurisdiction.

In *Railroad Commission of Wisconsin, et al.* v. *Chicago, B. & Q. R. Co.*, 42 Sup. Ct. Rep. 232, it is said:

> "Congress as the dominant controller of interstate commerce may, therefore, restrain undue limitation of the earning power of the interstate commerce system in doing state work. * * * it can impose any reasonable condition on a state's use of interstate carriers for intrastate commerce it deems necessary or desirable. This is because of the supremacy of the national power in this field. * * *
>
> "Action of the Interstate Commerce Commission in this regard should be directed to substantial disparity which operates as a real discrimination against, and obstruction to interstate commerce and must leave appropriate discretion to the state authorities to deal with intrastate rates as between themselves on the general level which the Interstate Commerce Commission has found to be fair to interstate commerce.

c. The Interstate Commerce Act, Paragraph (5) of Section 20 provides that:

> "The Commission may, in its discretion, prescribe the forms of any and all accounts, records and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movements of traffic, as well as the receipts and expenditures of moneys * * *, and it shall be unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission. * * *"

The Commission has prescribed a "Uniform System of Accounts for Telephone Companies."

This section of the Interstate Commerce Act must be read in the light of the fact that in conferring jurisdiction upon the Commission it was expressly provided that the provisions of the act should not apply to the transmission of messages by telephone wholly within one state.

So read the section will not admit of a construction that would result in withdrawing from the states the power to prescribe the forms of accounts as to purely intrastate business, nor to prohibit the keeping by the carriers of accounts as to such business, prescribed by the states.

If it was the intent in the enactment of this section to withdraw from the states the power to prescribe forms of accounts as to purely intrastate business, such intent cannot be given effect. The power of the states over purely intrastate business includes the power to regulate rates and the power of taxation. To the effective exercise of these powers, the power to regulate forms of accounts with respect to such business is essential. To say that the power of the states to regulate the rates for purely intrastate business remains intact, and that the states are without power over the subject of the depreciation charges which may be included in operating expenses, and that the extent of the inclusion of such charges in such expenses rests in the uncontrolled will of the carriers is a manifest absurdity, for the carriers through such uncontrolled power could at will render nugatory the states' power of regulation.

The Act was amended in 1920, authorizing the Commission to prescribe the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property.

The Commission has not as yet exercised the power

conferred. The matter is now the subject of investigation by it.

It is true, that the Uniform System of Accounts for Telephone Companies, prescribed by the Commission in 1912, eight years before the amendment to the Act now considered, does deal with the subject of depreciation expense. Such system of accounts, however, does not as the amendment requires, "prescribe the classes of property for which depreciation charges may properly be included under operating expenses" nor "the percentages of depreciation which shall be charged with respect to each of such classes of property." Such system of accounts merely requires the accounting company *to base its depreciation charges upon rules to be determined by itself,* which rules must be derived from "a consideration of the company's history and experience."

This subject was considered and a conclusion in accord with the contentions here advanced was reached in:

Indiana Bell Telephone Co. v. *Public Service Commission,* 300 Fed. Rep., 205, where the Court said:

> "Plaintiff urges that the commission was without jurisdiction to fix a rate of depreciation because it claims that that was a matter wholly within the jurisdiction of the Interstate Commerce Commission. I do not deem it necessary to go into the question of the relative rights of a state Public Utility Commission and of the Interstate Commerce Commission in regard to rate of depreciation, because I am satisfied that section 435 of the Transportation Act (Comp. St. Ann. Supp. 1923, par. 8592), shown in Exhibit 21, contemplates that the commission shall only arrive at a proper rate of depreciation by some of the usual and well known methods of investigation, and that until it has done so it cannot prescribe a rate of depreciation for other than bookkeeping and reporting purposes.

"The letter, notice, or order, whichever it may be termed, introduced in evidence, indicates that the Interstate Commerce Commission had not up to that time made any investigation or arrived at any rate which it deemed proper for rate-making purposes, and that it had not, therefore, at the time the Indiana commission acted in this case, assumed any jurisdiction or control over telephone rate making that would deprive the Indiana commission of its undoubted right to fix a rate of depreciation, if not thus affected."

Respectfully submitted,

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